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SUBJECT: JAMAICAN ECONOMY STAGNATES AMID SHOCKS, A REVIEW OF THE  
FIRST HALF OF 2008

REF: A. KINGSTON 648

[1](#)B. KINGSTON 422  
[1](#)C. KINGSTON 366  
[1](#)D. KINGSTON 111  
[1](#)E. KINGSTON 542  
[1](#)F. KINGSTON 703  
[1](#)G. KINGSTON 651  
[1](#)H. KINGSTON 571

SUMMARY  
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[1](#)1. (SBU) Growth in the Jamaican economy, suffering from a number of shocks, has slowed to less than one percent during the first half of [1](#)2008. The downturn was most evident in the goods producing sectors, which declined by 3.5 percent. Services grew by a moderate 1.7 percent fueled by robust tourism performance. The sluggish economic conditions occurred against the background of increasing macroeconomic instability and in particular price and foreign exchange market volatility. Inflation of 11.5 percent for the first half of 2008 already has exceeded the original target for the entire calendar year. Although the exchange rate has remained relatively stable, declining less than a one percent, it has been largely due to increased intervention by the Central Bank to temper demand pressures. Government of Jamaica (GOJ) operations also are outperforming targets due to a combination of reduced expenditure and higher revenue collections. But even this unlikely success story is tenuous, given the impact rising energy and food prices and non-performing state assets like Air Jamaica could have on expenditure. The Jamaican economy is expected to face even more serious challenges during the next six months, given the expected slowdown in investment and consumer spending following the meltdown of a number of alternative investment schemes (reftel A). Add to this the country's susceptibility to shocks, and the near term outlook dims. End summary.

Output Stagnates  
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[1](#)2. (SBU) Economic output for the first half of 2008 declined to less than one percent as a result of a number of shocks. Global challenges including increasing commodities prices and in particular crude oil, wheat, rice and fertilizer, as well as unusually heavy rains in February, provided the underlying impetus for the economic downturn (reftels C and D). The impact was particularly evident in the goods producing sectors, which, with the exception of the construction sector, stagnated. But it was the double digit downturn in agricultural output which underlined the negative performance. Agriculture was severely hampered by the residual effects of Hurricane Dean, which hit the island in August 2007. This, coupled with the heavy rainfall and fires associated with the subsequent drought, combined to decimate export crop production.

Mining output also declined due to decreasing bauxite production as a result of maintenance and equipment problems at a number of refineries--particularly disconcerting in an environment in which Jamaica could have capitalized on rising aluminum prices. Despite the fall in output, Jamaica's gross export earnings from bauxite/alumina grew by more than 14 percent in 2007 to USD 1.3 billion. Growth in the sector is expected to be 3 percent in 2008. While the construction sector improved, the major stimulus was provided by public sector projects. Increased tourist arrivals continued to provide the growth impetus in the services sector.

#### Macroeconomic Instability Emerges

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13. (SBU) Jamaica's vulnerability to external shocks, including rising international commodities prices, makes it susceptible to frequent bouts of instability. In fact, current rising external prices and domestic policy-induced measures have combined to fuel prices for the first half of 2008. Inflation of 11.5 percent for the six month period already has exceeded the original target of nine to ten percent. The movement was also 6.4 percentage points above the 5.1 percent recorded in the similar period of 2007. Most of the inflation was registered in urban areas, with soaring prices in energy (up 34.3 percent) and food (up 34.9 percent). The impact of rising oil prices was particularly devastating, given that Jamaica depends on imported crude oil for over 90 percent of its energy needs. Although the GOJ provided a three month subsidy on basic food items, the shock to domestic agriculture and the subsequent hike in domestic prices essentially nullified the benefits. Further impetus was provided by a number of policy induced measures including increased tax, transportation, and

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utility rates. The policy decisions were largely responsible for the near five percent rate of inflation recorded in May and June.

#### Monetary Policy Challenged

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14. (SBU) The increased prices have provided their own set of challenges to the Central Bank. Although the local currency has remained relatively stable, with the exchange rate depreciating by just over one percent for the first half of the year, the foreign exchange market has been relatively volatile. Attendant efforts to maintain exchange rate stability have come at a significant cost to fiscal and monetary policy. The Central Bank therefore has had to utilize all the instruments at its disposal to defend the currency. In particular, the bank has been forced to engage in open market operations (OMO), increasing interest rates by three percentage points (to 15 percent) for the first half of the year. In addition to crowding out private investment, the increased rates eventually will impact fiscal policy, as the higher cost of money will only magnify the debt burden. The bank also has had to frequently intervene in the market by selling foreign currency from its stock of net international reserves (NIR) to temper rising demand pressures. Despite the pressure on its foreign currency reserves, the NIR was supplemented with USD 250 million raised through the sale of government bonds on the capital markets and loans from multilateral lenders. In total the stock of NIR jumped by USD 350 million to USD 2.3 billion. But again, this and the OMO have not come without cost, as at the end of June the Central Bank recorded a loss of USD 26 million to implement its monetary policy.

15. (SBU) Soaring commodities prices also have fuelled a deterioration in the current account position, with the deficit climbing by USD 340 million to USD 538.6 million for the first three months of the year. A deterioration in the merchandise (goods) trade deficit was the main source of the widening, stemming from significant increases of USD 237.4 million (58.3 percent) and USD 38.9 million (22.6 percent) in the values of mineral fuels (crude oil and refined products) and manufactured goods imports, respectively. The impact of soaring mineral fuels has been softened by increased earnings from alumina and non-traditional exports. But even as other areas of the current account continue to decline,

remittances from Jamaicans living abroad remained resilient. Central Bank economist Chandar Henry told emboff that remittances for the first half of the year jumped an impressive 11.5 percent. These figures are not surprising to Noel Greenland of Western Union, the country's largest remittance company. Greenland told emboffs that in addition to the obligatory nature of the remittance flows, most overseas Jamaicans are employed in areas that have been relatively unscathed by the economic downturn in North America. Tourist arrivals also have remained buoyant as European and Canadian tourists are finding Jamaica a bargain. Arrivals from the U.S. climbed 7.7 percent due to the diversion of visitors from more expensive destinations in Europe. Stop over visitor arrivals climbed by 9.9 percent for the first five months of 2008. Antoinette Lyn, a statistician at the Jamaica Tourist Board, told emboff that barring any unforeseen challenges she expects both earnings and arrivals to continue on an upward trajectory.

#### Reforms Help Government Accounts

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16. (SBU) Even though the monetary side struggled, fiscal policy continued to outperform expectations, with government operations generating a deficit of USD 126 million for the first two months of the fiscal year; four percent better than projected. A combination of moderate spending and, more importantly, increased revenue collections were responsible for the improvement. The higher tax collection is attributable to Minister of Finance and the Public Service Audley Shaw's ambitious reform agenda. Shaw claims there has been a 37 percent increase in taxes collected in June 2008 from the same month last year. Ministry of Finance officials told Emboff that about USD 30 million of the USD 170 million in tax revenue collected is due to the tax amnesty.

#### But Debt Overhang Persists

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17. (SBU) Despite efforts to reduce the country's gargantuan debt stock, Jamaica continues to be the fourth most indebted country in the world, with a debt to GDP ratio of close to 130 percent (USD 14 billion) at the end of May. The problem is that the associated interest payments can run up to fifty cents out of every dollar of

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revenue, leaving government to borrow to finance principal payments and to a lesser extent some of its house keeping spending. Although Jamaica has a long history of debt, most of the load was accumulated between 1996 and 2003, when the debt to GDP ratio jumped by over 70 percentage points. The doubling is largely attributable to recurrent fiscal deficits and the absorption of liabilities from loss making public sector entities like Air Jamaica (reftel E). (Note: The airline has lost USD 85 million for the first five months of the year, building on a loss of USD 171 million for 2007. The GOJ hopes to privatize the airline by March 2009, End Note). The GOJ's medium-term goal is to balance the budget by fiscal year 2010/11 and bring the level of debt down to below 100 percent of GDP. While the government has garnered low cost loans from multilaterals, there continues to be an up tick in the stock of debt, with almost USD 50 million added during the first four months of 2008. And with GDP stagnating, the ratio could move in the wrong direction, eroding the medium-term goal.

#### And Other Vulnerabilities Remain

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18. (SBU) Several major alternative investment schemes including Cash Plus, CAREIF have collapsed since April. One of the largest, Olint, collapsed in July. It is not certain how much money was invested in the various schemes, but some major investors were affected by Olint; the impact of the collapse is expected to deal a serious blow to the economy in general and the real estate market in particular (reftel A). There also could be a downturn in domestic investment as affected investors recover from the fallout. The stalling of some investment projects also could result in the addition of a number of Jamaicans to the ranks of the unemployed, putting a dent in the consumer spending and consumption tax revenue needed to keep

the economy afloat. But the worst impact yet could be felt in the real estate market, which was partially driven up by a false sense of new wealth by those involved in the schemes. Add to this the over USD 200 million in debt accumulated by loss making entities like Air Jamaica, the National Road Operating and Construction Company, and the Jamaica Urban Transport Company (JUTC), and the burden on fiscal policy increases. And while the privatization of the Sugar Company of Jamaica was completed in recent days, the GOJ will have to absorb the USD 40 million redundancy costs.

#### Government's Reform Agenda

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¶9. (SBU) The GOJ's nine month economic performance has been largely set by Shaw's ambitious reform agenda, which includes: (1) fiscal discipline; (2) reduced bureaucracy; (3) investment promotion; (4) tax reform; (5) engagement of multilaterals; and (6) energy diversification. Shaw has been particularly passionate about tax reform and in particular an assault on corruption. As a precursor to the reform process, Shaw pledged to provide transparent governance so taxpayers receive value for their taxes. However, he has pointed out that almost USD 1 billion in tax arrears remains outstanding, of which over USD 600 million is owed by the private sector. To address the issue Shaw introduced a graduated tax amnesty program expected to end in October (reftel F). Shaw also has started reducing transfer taxes and stamp duties and is pledging to bring corporate taxes in line with personal income tax (25 percent) before further reducing both to 15 percent. Plans are on track to consolidate statutory deductions by the end of 2008, and legislation is being drafted for tax agencies to share information under a Tax Collection Act. Customs, which Shaw says is a hotbed for corruption, is under increased scrutiny, with the no-nonsense former Director of Elections Danville Walker recruited to overhaul operations. A number of top level tax officials suspected of either corruption or incompetence already have been suspended, transferred, or retired. There also has been a significant increase in the value of goods declared.

#### Reforms Yielding Positive Results

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¶10. (SBU) On May 19, 2008, Standard & Poor's Ratings Services affirmed its 'B' long-term and short-term sovereign credit ratings on Jamaica, while maintaining its stable outlook. According to S&P, the ratings were supported by the GOJ's commitment to fiscal discipline, debt reduction, and economic reinvigoration. The rating was also premised on continued political stability and capital market development. The IMF, in its 2008 Article IV Consultation, also considered the broad nature of Jamaica's structural agenda as appropriate, and even encouraged an expeditious implementation of reforms. IMF officials also welcomed the GOJ's pursuit of fiscal

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adjustment aimed at balancing the budget by 2011 and at establishing a virtuous cycle of lower debt and higher growth. However, they noted the adjustment effort must be underpinned by broad-ranging reforms of the tax system and the public service.

¶11. (SBU) The GOJ also has made good on its plan to engage multilaterals and has received commitments for over USD 130 million for fiscal year 2008/09, including USD 30 million for the tax reform initiative. The GOJ's reform agenda also has allowed it to benefit significantly from technical expertise, with the IMF providing a team of consultants to review the tax incentive system. In addition to a USD 1.6 million grant to focus on enhancing the accountability framework, the IDB also has provided consultants to work on the tax system, while the World Bank has been providing ongoing technical assistance. Positive results also have taken place on the divestment front, with the USTDA providing USD 820,000 in grant funds to assist in the privatization of Air Jamaica. The GOJ also has entered into an agreement with Brazilian company Infinity Bio-energy to take over the assets of the Sugar Company of Jamaica (SCJ). The government also has taken the decision to discontinue offering guarantees to public sector entities raising private financing, a practice which has contributed significantly to amount

of the debt accrued.

#### Energy a Binding Constraint, Jobs Elusive

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¶12. (SBU) Rising energy costs continue to reduce Jamaica's attractiveness to investors, especially in energy intensive sectors. Jamaicans now pay about USD 0.31 per kilowatt hour for electricity compared to USD 0.13 for other Caribbean countries. This is largely due to the fact that the country relies on imported oil for more than 90 percent (29 million barrels of crude) of its energy needs. In 2007 the country spent USD 2.2 billion (almost 25 percent of GDP) on oil imports, and this figure could climb to almost USD 3 billion or 30 percent of GDP by the end of 2008. Recognizing the magnitude of the problem, the GOJ has made a commitment to have 15 percent of its energy needs come from renewable sources by 2015. Minister of Energy Clive Mullings also outlined a number of energy conservation measures during his budget debate in July 2008. He also proposed the creation of legislation to allow for net metering. And while Don Gittens of Jamaica's Trade and Invest told emboff that the new government has been able to attract a number of tourism, information technology, and mining projects, to date it has fallen short on its promise of massive job creation. On the contrary, the GOJ has been forced to lay off almost 1,000 workers from some public sector entities, which were heavily overstaffed. Add to this the almost 2,000 expected to join the ranks of the unemployed due to the sale of the SCJ. The U.S. garment manufacturer Jockey will close its last plant in Jamaica by December ending 575 jobs. Jockey also closed a 600 worker plant in Clarendon Jamaica in 2007.

#### Outlook for Next Six Months

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¶13. (SBU) Rising prices remain one of the biggest threats to the Jamaican economy over the next six months particularly in the context of the meltdown in alternative investment schemes. The expected reduction in effective demand amidst rising prices could slow government and consumer spending as well as investment, which in turn will keep economic growth moribund. The spike in the cost of imported commodities will also feed expectations for higher wages as well as a demand for increased returns on investments. If these expectations are satisfied it could lead to further adjustments in domestic goods and services prices even when international prices recede. Higher international commodities prices combined with the erosion of traditional trade preferences could lead to a widening of the country's current account to over 15 percent of GDP. Respected financial analyst Keith Collister has told emboffs that this figure could escalate as high as 20 percent by the end of 2008. The Balance of Payments (BOP) situation would have been worse, if it were not for the concessionary terms offered under the Petrocaribe Agreement. The fact that Petrocaribe benefits have helped Jamaica avert economic disaster has not been lost on Prime Minister Bruce Golding. In recent months he has been warming up to Cuba and Venezuela in contrast to his pre-election stance (reftel G).

#### And Political Imperatives Emerge

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¶14. (SBU) Record prices and the current crime wave making life difficult for average Jamaicans and are likely to thwart the Jamaica Labor Party's (JLP) reform agenda (reftel H). Polls also show that Golding's favorability ratings have stagnated. Although Opposition

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Leader Portia Simpson-Miller is facing her own set of challenges, her ratings have rebounded. With these issues in mind, the GOJ could well stall or backtrack on its reform agenda to win back support, a concern expressed by Acting Deputy Financial Secretary at the Ministry of Finance and the Public Service, Courtney Williams.

#### Comment

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¶15. (SBU) The Jamaican economy is expected to face serious challenges during the next six months, particularly given the

expected slowdown in investment and consumer spending following the meltdown of alternative investment schemes. Add to this the country's susceptibility to natural disasters such as hurricanes, and the near-term outlook dims. Even in the face of these challenges, the GOJ is better served if it continues to embark on the reforms required to spur growth and development. Minister Shaw appears determined to remain on track for tax reform and bolstering anticorruption efforts regardless of the political costs. His efforts already are paying significant dividends, especially in tax collections. Shaw also has defied local critics and the opposition Finance Minister Omar Davies by garnering substantive loans and technical expertise from multilaterals. But, Shaw could find the next couple months to be particularly challenging as the slowing world economy takes a further toll on Jamaica. The single biggest threat to reform will come from emerging political dynamics with talks of a new election remaining topical. If this materializes, it could thwart, if not reverse, some of the reforms, as the government tries to regain popularity among a disenchanted electorate. End comment.

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